



DEFENSE CONTRACT AUDIT AGENCY
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IN REPLY REFER TO

PPD 730.5.4.1

2 June 2000
00-PPD-048 (R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA

SUBJECT: Audit Guidance on Estimating System Deficiencies Concerning Subcontractor Cost Analyses

Several resident audit offices reported, as an estimating system deficiency, a prime contractor's failure to perform required cost analyses of proposed subcontract acquisitions when cost or pricing data are required. The contractor argued that the Federal Acquisition Regulation does not require it to conduct cost analyses of subcontract proposals for which cost or pricing data are required prior to the negotiation of the prime contract, but rather that the cost analyses need only be performed prior to negotiation of the subcontract. To address the issue, we are providing the following discussion and guidance that clarifies the guidance in CAM 5-1209.3 Subcontract Price/Cost Analysis.

DISCUSSION

Requirement to Conduct Cost Analyses of Subcontract Proposals

A solicitation including the provision at FAR 52.215-20 (Requirements for Cost or Pricing Data or Information Other Than Cost or Pricing Data) may require the contractor to prepare and submit cost or pricing data and attachments in accordance with Table 15-2 of FAR 15.408. On the first page of the pricing proposal, the contractor is required to state in part that:

This proposal reflects our estimates and/or actual costs as of this date and conforms to the instructions in FAR 15.403-5(b)(1) and Table 15-2.

FAR 15.408, Table 15-2, II.A(2) states:

Obtain cost or pricing data from prospective sources for those acquisitions (such as subcontracts, purchase orders, material order, etc.) exceeding the threshold set forth in FAR 15.403-4 and not otherwise exempt, in accordance with FAR 15.403-1(b) (i.e., adequate price competition, commercial items, prices set by law or regulation or waiver).

The contractor is specifically directed to obtain cost or pricing data from prospective sources for acquisitions over the \$500,000 threshold in FAR 15.403-4 (if not otherwise exempt). The contractor is also required to conduct cost analyses of the subcontractor's submitted cost or pricing data. FAR 15.408, Table 15-2 II.A, states that the contractor should:

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Conduct cost analyses for all subcontracts when cost or pricing data are submitted by the subcontractor.

The time frame for obtaining the cost or pricing data and conducting the cost analyses is prior to the negotiation of the prime contract, since the provision requires the contractor to include the cost analyses along with its own cost or pricing data. FAR 15.408, Table 15-2, II.A states:

Include these analyses as part of your own cost or pricing data submissions for subcontracts expected to exceed the appropriate threshold in FAR 15.403-4.

In addition to the above provisions, FAR 15.408, Table 15-2, II.A(2) states:

In addition, provide a summary of your cost analysis and a copy of cost or pricing data submitted by the prospective source in support of each subcontract, or purchase order that is the lower of either \$10,000,000 or more, or both more than the pertinent cost or pricing data threshold and more than 10 percent of the prime contractor's proposed price.

Thus the regulation requires the prime contractor to provide both a summary of its cost analysis and a copy of cost or pricing data along with its own submission for those subcontracts that are expected to be the lower of either \$10 million or more, or both more than the cost or pricing data threshold (\$500,000) and more than 10 percent of the total price. There is a similar provision in FAR 15.404-3(c); however, it is directed to the contracting officer whereas the provision in FAR 15.408 Table 15-2 is specifically for the contractor submitting a proposal under FAR 52.215-20 when included in the solicitation.

Estimating System Deficiencies

The provision in DFARS 215.407-5-70 defines a significant estimating system deficiency as:

A shortcoming in the estimating system that is likely to consistently result in proposal estimates for total cost or a major cost element(s) that do not provide an acceptable basis for negotiation for fair and reasonable prices.

Subcontracts are often a significant portion of the contractor's proposal costs. When determining the price reasonableness of the prime contract, including subcontracts, FAR 15.404-3(a) specifies that the contracting officer consider whether the contractor has performed cost or pricing analyses of proposed subcontract prices. One of the potentially significant estimating system deficiencies listed in DFARS 215.407-5-70(d)(3)(ii) is "failure to perform subcontractor cost reviews as required." Therefore, a contractor's failure to comply with the provisions in FAR 15.408 Table 15-2 to conduct subcontractor cost analyses would constitute a significant estimating system deficiency.

While cost or pricing data as defined in FAR 15.401 includes historical cost data, a contractor's application of decrement factors based on such data to subcontractor proposals does

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not eliminate the contractor's requirement to conduct cost analyses of subcontractors' cost data. FAR 15.404-1(c)(2) lists various other procedures and techniques that would be appropriate in such an analysis to determine the reasonableness of the proposed costs.

GUIDANCE

- A prime contractor subject to FAR 52.215-20 (Requirements for Cost or Pricing Data or Information Other Than Cost or Pricing Data) is required to obtain subcontract cost or pricing data and conduct cost analyses for those subcontracts expected to exceed \$500,000 (where no exception applies), prior to the negotiation of the prime contract regardless of when the subcontract is negotiated. The cost analyses are to be submitted to the government along with the contractor's own cost or pricing data submissions.
- A prime contractor subject to FAR 52.215-20 (Requirements for Cost or Pricing Data or Information Other Than Cost or Pricing Data) is required to obtain cost or pricing data and conduct cost analyses for those subcontracts expected to exceed the lower of either \$10,000,000 or more, or both more than the pertinent cost or pricing data threshold and more than 10 percent of the prime contractor's proposed price. The contractor's subcontract cost analyses and the subcontractors' cost or pricing data are to be submitted to the government as part of the contractor's own cost or pricing data (before negotiation of the prime contract).
- A contractor's failure to perform subcontract cost analyses as required in FAR 15.408, Table 15-2, II.A represents a significant estimating system deficiency under DFARS 215.407-5-70(d)(3). When this estimating system deficiency is encountered, auditors should follow the guidance on issuing an estimating system flash report in CAM 9-310.
- A contractor's responsibility to conduct subcontract cost analyses when cost or pricing data are required is not satisfied by substituting the use of historical decrement factors. In these instances, the contractor's failure to conduct subcontract cost analyses when cost or pricing data are required would represent a significant estimating system deficiency under DFARS 215.407-5-70(d)(3).

Field audit office personnel should refer questions regarding this memorandum to their regional offices. Regions unable to answer, or with questions of their own, should contact Mrs. Elizabeth Boyce, Program Manager, or Ms. April Stephenson, Division Chief, Policy Programs Division, at (703) 767-2270 or e-mail at DCAA-PPD@dcaa.mil.

/signed/ Robert DiMucci

(for)

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